

STATE OF DELAWARE  
DELAWARE WATER POLLUTION CONTROL  
REVOLVING LOAN FUND

FINANCIAL STATEMENTS

JUNE 30, 2006

STATE OF DELAWARE  
DELAWARE WATER POLLUTION CONTROL  
REVOLVING LOAN FUND  
FINANCIAL STATEMENTS  
JUNE 30, 2006

INDEX

	Page
INDEPENDENT AUDITORS' REPORT	1-2
MANAGEMENT'S DISCUSSION AND ANALYSIS	3-8
FINANCIAL STATEMENTS	
Statements of Fund Net Assets	9
Statements of Revenues, Expenses and Changes in Fund Net Assets	10
Statements of Cash Flows	11
Notes to the Financial Statements	12-24
REPORT REQUIRED BY <u>GOVERNMENT AUDITING STANDARDS</u>	
Independent Auditors' Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With <u>Government Auditing Standards</u>	25-26
Schedule of Findings and Questioned Costs	27-28

## Independent Auditors' Report

To the Management  
Delaware Water Pollution Control  
Revolving Loan Fund  
State of Delaware

We have audited the accompanying financial statements of Delaware Water Pollution Control Revolving Loan Fund (the Fund) of the State of Delaware, as of and for the years ended June 30, 2006 and 2005, as listed in the table of contents. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to the financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the respective financial position of Delaware Water Pollution Control Revolving Loan Fund, as of June 30, 2006 and 2005, and the respective changes in financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1, the financial statements present only the Fund and are not intended to present fairly the financial position of the State of Delaware, and the results of its operations and cash flows of its proprietary fund types in conformity with accounting principles generally accepted in the United States of America.

Thomas John Shopa, CPA, CFP, CVA  
Charles H. Elter, CPA, CFP  
Robert S. Smith, CPA  
Ronald E. Derr, CPA  
George G. Fournaris, CPA, CGFM

Donald S. Emenheiser, CPA, CFP, MBA  
Edward T. Gallagher, CPA, CIA  
Dana L. Ketterer, CPA  
Clyde G. Hartman, CPA/ABV, CFE, CVA  
Cameron B. McDonald, CPA, CCIFP  
Jean D. Lloyd, CPA  
Scott G. Sipple, Jr., CPA  
Stuart A. Solomon, CPA (NJ)

Members of:  
American Institute of CPA's  
Private Companies Practice Section  
Delaware Society of CPA's

Certified Public Accountants  
A Professional Association

270 Presidential Drive  
Wilmington, DE 19807  
(302) 656-5500  
(302) 656-8024 Fax

704 Rehoboth Avenue  
Rehoboth Beach, DE 19971  
(302) 227-4872  
(302) 227-4873 Fax  
[www.mcbrideshopa.com](http://www.mcbrideshopa.com)



An Independent Member of the BDO Seidman Alliance

## Independent Auditors' Report (Cont'd.)

In accordance with Government Auditing Standards, we have also issued our report dated October 19, 2006, on our consideration of the Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of the audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audit.

Management's Discussion and Analysis on pages 3 through 8 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

*McBride, Shapiro & Co*

Wilmington, Delaware  
October 19, 2006

STATE OF DELAWARE  
DEPARTMENT OF NATURAL RESOURCES AND ENVIRONMENTAL CONTROL  
WATER POLLUTION CONTROL REVOLVING LOAN FUND  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
JUNE 30, 2006

(\$000's omitted)

As management of the Delaware Water Pollution Control Revolving Fund ("Fund"), we offer readers of the Fund's financial statements this narrative overview and analysis of the financial activities of the Fund for the fiscal year ended June 30, 2006. All amounts unless otherwise indicated are expressed in thousands of dollars.

This section of the Fund's annual financial report presents management's discussion and analysis of the financial performance during the fiscal year. Please read it in conjunction with the Fund's financial statements, which follow this section.

#### Overview of the Financial Statements

This discussion and analysis is an introduction to the Fund's basic financial statements. The Fund's basic financial statements are comprised of two components: fund financial statements and notes to the financial statements.

#### Financial Highlights

In FY 2006 the Delaware Department of Natural Resources and Environmental Control ("DNREC") was awarded its twelfth capitalization grant from the U.S. Environmental Protection Agency ("EPA"). As of June 30, 2006 DNREC has received capitalization grants in an aggregate amount of \$113,661 since the inception of the Fund. As of June 30, 2006, the State of Delaware has provided state match funds of \$22,732 since the inception of the Fund. The combined total capitalization amount has been \$136,393 since the inception of the Fund.

The Fund realized operating income of \$1,402 in fiscal year 2006, which represents an increase of 29% from fiscal year 2005. Grants received from Federal and State governments totaled \$14,941 in fiscal year 2006, an 80% increase from fiscal year 2005. Increase in grants received was due to the increase in loan disbursements, which are reimbursed by grants.

STATE OF DELAWARE  
DEPARTMENT OF NATURAL RESOURCES AND ENVIRONMENTAL CONTROL  
DELAWARE WATER POLLUTION CONTROL REVOLVING LOAN FUND  
MANAGEMENT'S DISCUSSION AND ANALYSIS (Cont'd.)  
JUNE 30, 2006

(\$000's omitted)

Financial Highlights (continued)

Operating revenues (including interest income on loans) increased \$464 or 27% from the previous year.

Loans made totaled \$25,686 during the fiscal year, which represents an increase of \$16,823 or 190% from the previous fiscal year. Increase in loan disbursements is primarily a result of several new large municipal loans being disbursed during fiscal year 2006.

Loan originations (commitments) totaled \$13,655 as of June 30, 2006, which represents an increase of \$5,213 from the previous year, or 62%.

Loan collections (principal) totaled \$3,695 during the fiscal year. This represents a decrease of \$9 or less than 1% from the previous year. Principal loan collections will continue to grow as the number of loans outstanding increases.

STATE OF DELAWARE  
DEPARTMENT OF NATURAL RESOURCES AND ENVIRONMENTAL CONTROL  
DELAWARE WATER POLLUTION CONTROL REVOLVING LOAN FUND  
MANAGEMENT'S DISCUSSION AND ANALYSIS (Cont'd.)  
JUNE 30, 2006

(\$000's omitted)

Statement of Net Assets

The following condensed statement of net assets (thousands of dollars) shows a summary of changes in dollars and percentages between fiscal years:

	2006	2005	Increase/ Decrease Amount	Increase/ Decrease %
ASSETS				
CURRENT ASSETS				
Cash	\$ 34,272	\$ 39,492	\$ (5,220)	(13%)
Grants receivable	3,202	39	3,163	8,110%
Administrative fees receivable	1,116	837	279	33%
Interest receivable	203	103	100	97%
Loans receivable - current	3,733	3,397	336	10%
	<u>42,526</u>	<u>43,868</u>	<u>(1,342)</u>	<u>(3%)</u>
NONCURRENT ASSETS				
Loans receivable - less current portion	<u>99,352</u>	<u>77,617</u>	<u>21,735</u>	<u>28%</u>
TOTAL ASSETS	<u>\$141,878</u>	<u>\$121,485</u>	<u>\$ 20,393</u>	<u>17%</u>
LIABILITIES AND RETAINED EARNINGS				
CURRENT LIABILITIES				
Vouchers payable	<u>\$ 2,669</u>	<u>\$ 87</u>	<u>\$ 2,582</u>	<u>2,968%</u>
TOTAL LIABILITIES	<u>2,669</u>	<u>87</u>	<u>2,582</u>	<u>2,968%</u>
NET ASSETS	<u>139,209</u>	<u>121,398</u>	<u>17,811</u>	<u>15%</u>
TOTAL LIABILITIES & NET ASSETS	<u>\$141,878</u>	<u>\$121,485</u>	<u>\$ 20,393</u>	<u>17%</u>

STATE OF DELAWARE  
DEPARTMENT OF NATURAL RESOURCES AND ENVIRONMENTAL CONTROL  
DELAWARE WATER POLLUTION CONTROL REVOLVING LOAN FUND  
MANAGEMENT'S DISCUSSION AND ANALYSIS (Cont'd.)  
JUNE 30, 2006

(\$000's omitted)

Statement of Net Assets (continued)

The combined total net assets of the Fund for the year ending June 30, 2006 increased by 17%.

Cash decreased \$5,220 or 13% to \$34,272 primarily because funds were disbursed for loans, and the fund disbursing the loans, due to timing, had not yet drawn down from federal and state grants the corresponding amount.

Total liabilities' increase of \$2,582 was due to the increase in vouchers payable at the end of the fiscal year. Vouchers payables represent the amount of disbursements/payments which were requested/earned in fiscal year 2006 but not paid until the following fiscal year. The increase is due to timing and does not reflect any long term trend.

Statement of Revenue, Expenses and Changes in Fund Net Assets

The following schedule summarizes the statement of revenue, expenses and changes in net assets (thousands of dollars) of the Fund for the fiscal years ended June 30, 2006 and 2005:



STATE OF DELAWARE  
DEPARTMENT OF NATURAL RESOURCES AND ENVIRONMENTAL CONTROL  
DELAWARE WATER POLLUTION CONTROL REVOLVING LOAN FUND  
MANAGEMENT'S DISCUSSION AND ANALYSIS (Cont'd.)  
JUNE 30, 2006

(\$000's omitted)

	2006	2005	Increase/ (Decrease) Amount	Increase/ (Decrease) %
OPERATING REVENUES				
Interest income on loans	\$ 931	\$ 649	\$ 282	43%
Administrative fee revenue	1,255	1,072	183	17%
Application fees	2	3	(1)	(33%)
Other income	1	1	-	-
	<u>2,189</u>	<u>1,725</u>	<u>464</u>	<u>27%</u>
OPERATING EXPENSES				
Reimbursable expenditures under operating grants				
Personnel costs	527	463	64	14%
Travel	3	3	-	-
Contractual services	184	161	23	14%
Supplies	12	11	1	9%
Other expenses	61	2	59	2950%
Loans made	25,686	8,863	16,823	190%
	<u>26,473</u>	<u>9,503</u>	<u>16,970</u>	<u>179%</u>
Adjustments to reconcile reimbursable expenditures to operating expenses				
Less: Loans made	<u>(25,686)</u>	<u>(8,863)</u>	<u>(16,823)</u>	<u>(190%)</u>
TOTAL OPERATING EXPENSES	<u>787</u>	<u>640</u>	<u>147</u>	<u>23%</u>
OPERATING INCOME	1,402	1,085	317	29%
NONOPERATING REVENUE				
Interest income on deposits	1,467	686	781	114%
Contributions - EPA	12,437	6,904	5,533	80%
Contributions - State of Delaware	2,504	1,381	1,123	81%
	<u>16,408</u>	<u>8,971</u>	<u>7,437</u>	<u>83%</u>
CHANGE IN NET ASSETS	17,810	10,056	<u>\$ 7,754</u>	<u>77%</u>
BEGINNING NET ASSETS	<u>121,398</u>	<u>111,342</u>		
ENDING NET ASSETS	<u>\$139,208</u>	<u>\$121,398</u>		

STATE OF DELAWARE  
DEPARTMENT OF NATURAL RESOURCES AND ENVIRONMENTAL CONTROL  
DELAWARE WATER POLLUTION CONTROL REVOLVING LOAN FUND  
MANAGEMENT'S DISCUSSION AND ANALYSIS (Cont'd.)  
JUNE 30, 2006

(\$000's omitted)

Statement of Revenue, Expenses and Changes in Fund Net Assets (continued)

The Fund reported operating income of \$1,402, which represents an increase of \$317 or 29%. This is primarily a result of increased loan interest and administrative fees, which are monies received as part of loan repayments. Borrowers are required to pay interest and administrative fees on funds disbursed during construction as well as throughout the life of the loan, consequently, as the amount of loans outstanding increases for the Fund, income from interest and administrative fees will also increase. The Fund reported an overall increase of \$17,810 in total net assets for the fiscal year ended June 30, 2006.

Federal grant revenue increased by \$5,533 or 80%, and the State match increased by \$1,123, as a result of the increased amount of loan disbursements made in fiscal year 2006.

Total operating expenses increased \$147 or 23%, mostly as a result of increased personnel costs and contractual service costs.

Requests for Information

This financial report is designed to provide a general overview of the Fund's finances to the users of such data. Requests for additional copies of this report, questions concerning any of the information in this report, and requests for additional financial information should be addressed to:

Greg Pope, PE  
State of Delaware  
Department of Natural Resources & Environmental Control  
Division of Water Resources  
5 E. Reed Street, Suite 200  
Dover, DE 19901

STATE OF DELAWARE  
DELAWARE WATER POLLUTION CONTROL  
REVOLVING LOAN FUND  
STATEMENTS OF FUND NET ASSETS  
JUNE 30, 2006 AND 2005

	2006				2005			
	Federal Administrative Fund	Capital Reserve Loan Fund	Non Federal Administrative Fund	Total	Federal Administrative Fund	Capital Reserve Loan Fund	Non Federal Administrative Fund	Total
<b>ASSETS</b>								
<b>CURRENT ASSETS</b>								
Cash	\$ 13,225	\$ 28,652,202	\$ 5,606,716	\$ 34,272,143	\$ 7,991	\$ 34,422,908	\$ 5,061,459	\$ 39,492,358
Grants receivable	-	3,202,427	-	3,202,427	-	38,903	-	38,903
Administrative fees receivable	-	-	1,116,077	1,116,077	-	-	837,086	837,086
Interest receivable	-	202,582	-	202,582	-	103,191	-	103,191
Loans receivable - current	-	3,733,033	-	3,733,033	-	3,396,417	-	3,396,417
	13,225	35,790,244	6,722,793	42,526,262	7,991	37,961,419	5,898,545	43,867,955
<b>NONCURRENT ASSETS</b>								
Loans receivable - less current portion	-	99,351,829	-	99,351,829	-	77,617,053	-	77,617,053
	13,225	135,142,073	6,722,793	141,878,091	7,991	115,578,472	5,898,545	121,485,008
<b>TOTAL ASSETS</b>								
	\$ 13,225	\$ 135,142,073	\$ 6,722,793	\$ 141,878,091	\$ 7,991	\$ 115,578,472	\$ 5,898,545	\$ 121,485,008
<b>LIABILITIES AND NET ASSETS</b>								
<b>CURRENT LIABILITIES</b>								
Vouchers payable	-	2,642,439	27,000	2,669,439	-	38,903	47,686	86,589
	-	2,642,439	27,000	2,669,439	-	38,903	47,686	86,589
<b>TOTAL LIABILITIES</b>								
	13,225	132,499,634	6,695,793	139,208,652	7,991	115,539,569	5,850,859	121,398,419
<b>NET ASSETS - unrestricted</b>								
	13,225	135,142,073	6,722,793	141,878,091	7,991	115,578,472	5,898,545	121,485,008
<b>TOTAL LIABILITIES &amp; NET ASSETS</b>								
	\$ 13,225	\$ 135,142,073	\$ 6,722,793	\$ 141,878,091	\$ 7,991	\$ 115,578,472	\$ 5,898,545	\$ 121,485,008

The accompanying notes are an integral part of these statements.

STATE OF DELAWARE  
DELAWARE WATER POLLUTION CONTROL  
REVOLVING LOAN FUND  
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN FUND NET ASSETS  
YEARS ENDED JUNE 30, 2006 AND 2005

	2006				2005			
	Federal Administrative Fund	Capital Reserve Loan Fund	Non Federal Administrative Fund	Total	Federal Administrative Fund	Capital Reserve Loan Fund	Non Federal Administrative Fund	Total
<b>OPERATING REVENUES</b>								
Interest Income on loans	-	\$ 930,841	\$ -	\$ 930,841	\$ -	\$ 649,201	\$ -	\$ 649,201
Administrative fee revenue	-	-	1,255,197	1,255,197	-	-	1,072,082	1,072,082
Application Fees	-	-	2,005	2,005	-	-	3,183	3,183
Other Income	-	1,195	-	1,195	-	1,226	-	1,226
	-	932,036	1,257,202	2,189,238	-	650,427	1,075,265	1,725,692
<b>OPERATING EXPENSES</b>								
Reimbursable Expenditures Under								
Personnel costs	98,731	-	428,091	526,822	123,560	-	339,429	462,989
Travel	-	-	3,170	3,170	-	-	2,893	2,893
Contractual Services	44,953	-	139,418	184,371	51,851	-	109,436	161,287
Supplies and Office Expenses	158	-	11,681	11,839	-	-	11,107	11,107
Other Expenses	58,530	59	2,839	61,428	-	1,115	1,515	2,630
Loans made	-	25,685,781	-	25,685,781	-	8,862,553	-	8,862,553
	202,372	25,685,840	585,199	26,473,411	175,411	8,863,668	464,380	9,503,459
<b>Adjustments to Reconcile</b>								
Reimbursable Expenditures	-	(25,685,781)	-	(25,685,781)	-	(8,862,553)	-	(8,862,553)
to Operating Expenses	-	(25,685,781)	-	(25,685,781)	-	(8,862,553)	-	(8,862,553)
Less: Loans made	-	-	-	-	-	-	-	-
	202,372	59	585,199	787,630	175,411	1,115	464,380	640,906
<b>TOTAL OPERATING EXPENSES</b>								
	(202,372)	931,977	672,003	1,401,608	(175,411)	649,312	610,885	1,084,786
<b>OPERATING INCOME (LOSS)</b>								
<b>NONOPERATING REVENUE</b>								
Interest income on deposits	5,652	1,288,367	172,931	1,466,950	-	600,929	85,380	686,309
Contributions - EPA	169,440	12,268,140	-	12,437,580	147,038	6,757,346	-	6,904,384
Contributions - State	32,514	2,471,581	-	2,504,095	27,868	1,353,510	-	1,381,378
	207,606	16,028,088	172,931	16,408,625	174,906	8,711,785	85,380	8,972,071
<b>CHANGE IN NET ASSETS - unrestricted</b>								
	5,234	16,960,065	844,934	17,810,233	(505)	9,361,097	696,265	10,056,857
<b>BEGINNING NET ASSETS</b>								
	7,991	115,539,569	5,850,859	121,398,419	8,496	106,178,472	5,154,594	111,341,562
<b>ENDING NET ASSETS - unrestricted</b>								
	\$ 13,225	\$ 132,499,634	\$ 6,695,793	\$ 139,208,652	\$ 7,991	\$ 115,539,569	\$ 5,850,859	\$ 121,398,419

The accompanying notes are an integral part of these statements.

STATE OF DELAWARE  
DELAWARE WATER POLLUTION CONTROL  
REVOLVING LOAN FUND  
STATEMENTS OF CASH FLOWS  
YEARS ENDED JUNE 30, 2006 AND 2005

	<u>2006</u>	<u>2005</u>
Cash flows from operating activities		
Loan collections	\$ 3,695,007	\$ 3,704,732
Interest received from borrowers	783,063	652,764
Administrative fee revenue	976,206	902,299
Application fees and other revenue	3,200	3,952
Loan disbursements	(23,114,476)	(8,862,888)
General expenses paid	(808,316)	(620,959)
Net cash provided (used) by operating activities	(18,465,316)	(4,220,100)
Cash flows from noncapital financing activities		
Grants received from EPA	9,708,060	6,900,420
Grants received from State of Delaware	2,070,091	1,380,571
Net cash provided by noncapital financing activities	11,778,151	8,280,991
Cash flows from investing activities		
Interest on deposits	1,466,950	686,309
Net cash provided by investing activities	1,466,950	686,309
INCREASE IN CASH AND CASH EQUIVALENTS	(5,220,215)	4,747,200
Cash and cash equivalents, beginning of year	39,492,358	34,745,158
Cash and cash equivalents, end of year	<u>\$ 34,272,143</u>	<u>\$ 39,492,358</u>
Cash flows from operating activities		
Operating income	\$ 1,401,608	\$ 1,084,786
Adjustments to reconcile operating income to net cash provided by operating activities:		
Administrative fees receivable	(278,991)	10,627
Interest receivable	(99,391)	(192,664)
Other receivables	-	-
Loans receivable	(22,071,392)	(5,172,808)
Vouchers payable	2,603,533	49,959
Accrued expenses	(20,683)	-
Net cash used by operating activities	<u>\$ (18,465,316)</u>	<u>\$ (4,220,100)</u>

The accompanying notes are an integral part of these statements.

STATE OF DELAWARE  
DELAWARE WATER POLLUTION CONTROL  
REVOLVING LOAN FUND  
NOTES TO THE FINANCIAL STATEMENTS  
JUNE 30, 2006

**NOTE 1    SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

This summary of significant accounting policies of the Delaware Water Pollution Control Revolving Loan Fund ("Fund" or "SRF") is presented to assist in understanding the Fund's financial statements. The financial statements and notes are representations of the Fund's management which is responsible for their integrity and objectivity. These accounting policies conform to generally accepted accounting principles and have been consistently applied in the preparation of the financial statements.

**General Background**

The Fund was created by the 1990 session of the Delaware General Assembly and received its first state appropriation on July 1, 1990. The Fund's purpose is to make below-market interest rate loans to local governments, individuals, and other qualifying applicants under the Environmental Protection Agency's ("EPA") Capitalization Grants for State Revolving Funds federal assistance program. The Fund's enabling legislation empowers the Department of Natural Resources and Environmental Control ("DNREC") to administer the Fund.

**Basis of Accounting**

The Fund accounts for its operations as a proprietary enterprise fund under governmental accounting standards. Accordingly, the economic resource measurement focus and the accrual basis of accounting is followed and commercial accounting principles are applied. The accrual basis of accounting recognizes revenues in the accounting period in which they are earned and become measurable, and expenses in the accounting period in which they are incurred and become measurable without regard to the receipt or payment of cash.

STATE OF DELAWARE  
DELAWARE WATER POLLUTION CONTROL  
REVOLVING LOAN FUND  
NOTES TO THE FINANCIAL STATEMENTS  
JUNE 30, 2006

**SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd.)**

**Basis of Accounting (cont'd.)**

The Fund is a special purpose government proprietary fund engaged only in business-type activities. In accordance with the provisions of Governmental Accounting Standards Board Statement No. 34, the Fund needs only to present the financial statements required for proprietary funds, the required supplemental information and Management's Discussion and Analysis.

**Type of Entity and Division of Funds**

The Fund's activities are accounted for as a distinct operating unit and a Proprietary Fund within DNREC's Division of Water Resources. Accordingly, the financial statements of the Fund are intended to present the financial position, results of operations and cash flows of proprietary fund types of only that portion of the funds of the State of Delaware that are attributable to the transactions of the Fund.

The Fund is divided into three sub-funds:

- The Federal Administrative Fund, which accounts for program-related administrative activities;
- The Capital Reserve Loan Fund, which accounts for capital lending and repayment activities; and
- The Non Federal Administrative Fund, which accounts for monies which the State of Delaware ("State") has been authorized, by the EPA, to allocate from the SRF program and use at its own discretion, without federal oversight.

STATE OF DELAWARE  
DELAWARE WATER POLLUTION CONTROL  
REVOLVING LOAN FUND  
NOTES TO THE FINANCIAL STATEMENTS  
JUNE 30, 2006

**SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd.)**

**Adoption of GASB Statement 20**

The Fund has adopted the provision of GASB Statement 20, "Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting", which provides for the consistent application or nonapplication to proprietary and nonexpendable trust funds of pronouncements of the Financial Accounting Standards Board ("FASB"), issued after November 30, 1989. Accordingly, the Fund has elected not to adopt FASB pronouncements issued after November 30, 1989, unless GASB specifically adopts such pronouncements.

**Recognition of Revenues**

Federal assistance provided by the Capitalization Grants for the SRF program is earned when qualified expenditures are incurred by the borrowers and the Fund. Matching funds provided by the State are considered earned by the same criteria. Amounts earned in excess of grant monies received from the EPA and the State are recorded as grants receivable, whereas a deficiency of such amounts is considered deferred grant revenue.

To permit comparability to grant revenues earned and fiscal budgets, expenditures reimbursable under the Fund's program guidelines are listed separately by object category and subtotaled in the statement of revenues, expenses and changes in net assets.

Operating revenues include those that result from the Fund's lending activities. Non-operating revenues include those from non-capital financing and investing activities.



STATE OF DELAWARE  
DELAWARE WATER POLLUTION CONTROL  
REVOLVING LOAN FUND  
NOTES TO THE FINANCIAL STATEMENTS  
JUNE 30, 2006

**SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd.)**

**Cash Equivalents**

Cash and cash equivalents consist of demand deposits, short-term money market funds and other deposits held by financial institutions, generally with a maturity of three months or less when purchased. Cash and cash equivalents are reported as deposits.

Cash and cash equivalents as reported on the statement of net assets are held by the State Treasurer's Office. All cash deposited with the State Treasurer by State agencies is maintained by the Treasurer in various pooled investment funds. The State Treasurer invests the deposited cash including the cash float in short-term securities and other investments.

**Use of Estimates**

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

STATE OF DELAWARE  
DELAWARE WATER POLLUTION CONTROL  
REVOLVING LOAN FUND  
NOTES TO THE FINANCIAL STATEMENTS  
JUNE 30, 2006

**NOTE 2    CASH**

*Cash:* "Cash" as reported on the statement of net assets represents the Fund's allocated share of cash, cash equivalents and investments under the control of the Treasurer of the State of Delaware ("Treasurer"). All cash is deposited with the Treasurer by state agencies and maintained by the Treasurer in various pooled funds. The Treasurer invests the deposited cash including cash float in short-term securities and other investments. However, the Fund may deposit or withdraw cash at any time without prior notice or penalty. Interest income is credited to the Fund based on the weighted average rate of return on the State's monies applied to the Fund's average daily cash balance. The classification of pooled cash of the Fund is not determinable at the entity level. Pooled investments represent those investments in units of a pool rather than specific securities. As a result, such investments are not categorized as to risk because they are not evidenced by securities that exist in a physical or book-entry form.

*The Cash Management Policy Board:* The State of Delaware's ("State") policy for the investment of State Funds is the responsibility of the Cash Management Policy Board (the "Board"). The Board, created by State law, establishes policies for and the terms, conditions, and other matters relating to the investment of all money belonging to the State except money in any State pension fund and money held under the State deferred compensation program.

*Investment Guidelines and Management:* The investment guidelines adopted by the Board provide, among other things, that no more than 10% of the portfolio may be invested in obligations of any one issuer other than the U.S. Government. Investments may be made only in fixed income instruments with maturities of up to five years in certain circumstances.

STATE OF DELAWARE  
DELAWARE WATER POLLUTION CONTROL  
REVOLVING LOAN FUND  
NOTES TO THE FINANCIAL STATEMENTS  
JUNE 30, 2006

**CASH (Cont'd.)**

*Collateralization Requirements:* All State funds are required by law to be collateralized by direct obligations of, or obligations which are guaranteed by the United States of America, or other suitable obligations as determined by the Board, unless the Board shall find such collateralization not in the best interest of the State. The Board has determined that certificates of deposit and time deposits must be collateralized unless the bank issuing the certificate has assets of not less than \$5 billion and is rated not lower than "B" by Fitch, Inc.'s Bank Watch Service. The Board has also determined that State's demand deposits need not be collateralized provided that any bank that holds these funds has for the last two years, a return on average assets of 5% or greater and an average equity - capital ratio of at least 1:20.

If the bank does not meet the above criteria, collateral must consist of one or more of the following:

- (a) U.S. Government securities;
- (b) U.S. Government agency securities;
- (c) Federal Home Loan Board letters of credit;
- (d) State of Delaware securities; or
- (e) Securities of a political subdivision of the State with a Moody's Investors Service rating of "A" or better.

Additionally, the bank must ensure that those securities pledged as collateral have a market value equal to or greater than 102% of the ledger balance(s) in the account(s) each day and ensure that securities pledged are identified as held in the State's name and are segregated on the bank's records.

STATE OF DELAWARE  
DELAWARE WATER POLLUTION CONTROL  
REVOLVING LOAN FUND  
NOTES TO THE FINANCIAL STATEMENTS  
JUNE 30, 2006

**CASH (Cont'd.)**

The cash account in the Federal Administrative Fund represents grant funds drawn to pay administrative expenses of the fund. The grant agreement permits an amount up to 4% of grant revenues over the life of the program for these administrative expenses.

The cash account in the Capital Reserve Loan Fund represents all principal and interest received from Fund loans. These dollars are earmarked for future loans in accordance with applicable federal regulations.

Cash from administrative fees on municipal loans is recorded in the Non-Federal Administrative Fund, and is then available to the State for use at its discretion.

STATE OF DELAWARE  
DELAWARE WATER POLLUTION CONTROL  
REVOLVING LOAN FUND  
NOTES TO THE FINANCIAL STATEMENTS  
JUNE 30, 2006

**NOTE 3    LOANS RECEIVABLE**

The loans receivable account is made up of the following major categories:

	<u>2006</u>	<u>2005</u>
Municipal		
• Sussex County Council	\$ 56,892,363	\$48,604,031
• City of Wilmington	11,757,392	12,683,284
• City of Seaford	5,548,457	5,902,808
• Kent County	3,349,625	3,498,029
• City of Milford	1,436,014	1,505,043
• Town of Selbyville	2,296,240	1,599,579
• Town of Laurel	4,608,702	848,587
• City of Dover	578,064	609,336
• Camden Wyoming Sewer & Water Authority	295,487	317,314
• Town of Milton	460,733	460,733
• Town of Millsboro	101,911	101,911
• Town of Bridgeville	1,368,364	1,245,639
• City of Lewes	6,888,277	452,185
• Rehoboth Bay Conservancy	2,024,591	305,940
• Town of Georgetown	2,323,078	-
Septic Rehabilitation Program	1,413,155	1,358,940
Agriculture Non-Point Source Loan Program	1,328,946	1,141,915
Dairy Loan Program	291,290	222,613
Underground Storage Tank Program	<u>122,173</u>	<u>155,583</u>
Total	<u>\$103,084,862</u>	<u>\$81,013,470</u>
Current portion	\$ 3,733,033	\$ 3,396,417
Long-term portion	<u>99,351,829</u>	<u>77,617,053</u>
Total	<u>\$103,084,862</u>	<u>\$81,013,470</u>

STATE OF DELAWARE  
DELAWARE WATER POLLUTION CONTROL  
REVOLVING LOAN FUND  
NOTES TO THE FINANCIAL STATEMENTS  
JUNE 30, 2006

**LOANS RECEIVABLE (Cont'd.)**

Interest charged on these loans ranges from 1.5% to 6.0% for both 2006 and 2005. Loan maturities vary, based on individual agreements. General Obligation and Municipal Revenue bonds are collateral for municipal loans; business assets and real estate are collateral for other loans.

There is no allowance for doubtful loans at June 30, 2006 and 2005 as all loans are secured and will eventually be collected. There were no material delinquent loan balances and no loan defaults for 2006 and 2005.

**NOTE 4      SIGNIFICANT SOURCE OF REVENUE - STATE REVOLVING  
FUND GRANT**

The Fund currently derives a significant portion of its revenue from EPA State Revolving Fund Capitalization Grant awards and mandatory state matching funds. The total funds awarded through a series of agreements during the federal capitalization period (October 1, 1990 through June 30, 2006) were \$136,393,176 which includes the federal portion of \$113,660,980, or five-sixths, and the state matching portion of \$22,732,196, or one-sixth.

According to Federal program guidelines, the Fund may spend up to four percent (4%) of the federal awards on administrative expenses. As previously described in Note 1, a separate Administrative Fund is used to account for such costs and related revenues.

The table below summarizes funding for the Fund over the capitalization period:

	<u>Federal</u>	<u>State</u>	<u>Total</u>
Awards made through June 30, 2006	<u>\$ 113,660,980</u>	<u>\$ 22,732,196</u>	<u>\$ 136,393,176</u>
Awards expended through June 30, 2006	<u>\$ 103,521,319</u>	<u>\$ 20,716,127</u>	<u>\$ 124,237,446</u>

STATE OF DELAWARE  
DELAWARE WATER POLLUTION CONTROL  
REVOLVING LOAN FUND  
NOTES TO THE FINANCIAL STATEMENTS  
JUNE 30, 2006

**NOTE 5    PENSION PLAN**

Employees of the Fund are considered employees of the State of Delaware ("State") and are covered under The State Employees' Pension Plan. Total pension cost of \$58,350 for 2006 and \$44,535 for 2005 is included in the financial statements as personnel costs. Certain significant plan provisions follow:

Detailed information regarding this plan is available in the Delaware Code and the Rules and Regulations of the Board of Pension Trustees.

Plan Description and Eligibility: The State Employees' Pension Plan is a cost-sharing multiple employer defined benefit plan that covers virtually all full-time or regular part-time employees of the State, including employees of other affiliated entities.

Service Benefits: Final average monthly compensation multiplied by 2.0% and multiplied by years of credited service prior to January 1, 1997 plus final average compensation multiplied by 1.85% and multiplied by years of credited service after December 31, 1996, subject to minimum limitations. For this plan, final average monthly compensation is the monthly average of the highest three years of compensation.

Vesting: Five (5) years of credited service.

Retirement: Age 62 with five (5) years of credited service; age 60 with 15 years of credited service; or after 30 years of credited service at any age.

Disability Benefits: Same as Service Benefits. Employee must have five (5) years of credited service.

Survivor Benefits: If employee is receiving a pension or is active with at least five (5) years of credited service, eligible survivor receives 50% (or 75% with 3% reduction of benefit) of the benefit the employee would have received at age 62.

STATE OF DELAWARE  
DELAWARE WATER POLLUTION CONTROL  
REVOLVING LOAN FUND  
NOTES TO THE FINANCIAL STATEMENTS  
JUNE 30, 2006

**PENSION PLAN (Cont'd.)**

Contributions:

- Employer – Determined by Board of Pension Trustees.
- Employee - 3 % of earnings in excess of \$6,000.

Death Benefit: \$7,000 per member.

The Delaware Public Employees' Retirement System issues a publicly available financial report that includes financial statements and required supplementary information of the plan. The financial report may be obtained by writing to the State Board of Pension Trustees and Office of Pensions, McArdle Building, Suite #1, 860 Silver Lake Boulevard, Dover, Delaware 19904-2402.

**NOTE 6    COMMITMENTS AND CONTINGENCIES**

**Operating Lease**

Beginning July 1, 1997, DNREC entered into a lease for office space, on behalf of the Fund, of which the Fund pays 75%. The three-year operating lease was effective from July 1, 1997 through June 30, 2000, but has been extended since then. Most recently, the lease was renewed for a one-year term expiring January 31, 2006, and currently continues on a month-to-month basis.

Rent expense, which is included in the financial statements as contractual services, was \$33,879 in 2006 and \$29,402 in 2005.



STATE OF DELAWARE  
DELAWARE WATER POLLUTION CONTROL  
REVOLVING LOAN FUND  
NOTES TO THE FINANCIAL STATEMENTS  
JUNE 30, 2006

**COMMITMENTS AND CONTINGENCIES (Cont'd.)**

**Loans**

Binding loan commitments as of June 30, 2006 are \$13,654,760.

**Cost Reimbursement Contracts**

The Fund derives all of its non-operating revenue from EPA Capitalization Grants for State Revolving Fund program and mandatory state matching funds which are contracts based on the reimbursement of allowable costs related to the program. Costs are subject to review by the EPA. Any adjustments arising from disallowed costs are recorded in the Fund's financial statements.

STATE OF DELAWARE  
DELAWARE WATER POLLUTION CONTROL  
REVOLVING LOAN FUND  
NOTES TO THE FINANCIAL STATEMENTS  
JUNE 30, 2006

**NOTE 7    RISK MANAGEMENT**

The Fund is insured under the State of Delaware's insurance plans. The State is exposed to various risks of losses related to workers' compensation, employee health-care and accident, automobile accident, police professional malpractice and property and casualty claims. It is the policy of the State not to purchase commercial insurance to cover these risks. Instead, State management believes it is more economical to manage its risk internally and thus, covers all claim settlements and judgments out of its General Fund. The State continues to carry commercial insurance for all other risks of loss, including general liability and the remainder of the property and casualty liability. There have been no significant reductions in insurance coverage from prior years. In the past three years of insured coverage, settled claims have not exceeded commercial coverage.

Claim liabilities are reported when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated. Liabilities include an amount for claims that have been incurred by not reported. Because actual claim liabilities depend on such complex factors as inflation, changes in legal doctrines and damage awards, the process does not result in an exact amount. Claim liabilities are re-evaluated annually to take into consideration recently settled claims, the frequency of claims, and other economic and social factors.

At June 30, 2006, there were no outstanding or pending claims against the Fund.

Independent Auditors' Report on Internal Control Over  
Financial Reporting and on Compliance and Other Matters  
Based on an Audit of Financial Statements Performed  
in Accordance with Government Auditing Standards

To the Management  
Delaware Water Pollution Control  
Revolving Loan Fund  
State of Delaware

We have audited the accompanying financial statements of the Delaware Water Pollution Control Revolving Loan Fund (the Fund) of the State of Delaware, as of and for the year ended June 30, 2006 and have issued our report thereon dated October 19, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Fund's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted a certain matter involving the internal control over financial reporting and its operation that we consider to be a reportable condition. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Fund's ability to initiate, record, process, and report financial data consistent with the assertions of management in the financial statements. The reportable condition is described in the accompanying Schedule of Findings and Questioned Costs as Condition 06-01.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that

Thomas John Shopa, CPA, CFP, CVA  
Charles H. Elter, CPA, CFP  
Robert S. Smith, CPA  
Ronald E. Derr, CPA  
George G. Fournaris, CPA, CGFM

Donald S. Emenheiser, CPA, CFP, MBA  
Edward T. Gallagher, CPA, CIA  
Dana L. Ketterer, CPA  
Clyde G. Hartman, CPA/ABV, CFE, CVA  
Cameron B. McDonald, CPA, CCIFF  
Jean D. Lloyd, CPA  
Scott G. Sipple, Jr., CPA  
Stuart A. Solomon, CPA (NJ)

Members of:  
American Institute of CPA's  
Private Companies Practice Section  
Delaware Society of CPA's

Certified Public Accountants  
A Professional Association

270 Presidential Drive  
Wilmington, DE 19807  
(302) 656-5500  
(302) 656-8024 Fax

704 Rehoboth Avenue  
Rehoboth Beach, DE 19971  
(302) 227-4872  
(302) 227-4873 Fax  
[www.mcbrideshopa.com](http://www.mcbrideshopa.com)

- 25 -

Independent Auditors' Report on Internal Control Over  
Financial Reporting and on Compliance and Other Matters  
Based on an Audit of Financial Statements Performed  
in Accordance with Government Auditing Standards (Cont'd.)

would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions, and accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we consider the reportable condition listed above to be a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Fund's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under Government Auditing Standards.

This report is intended for the information of the Fund's management, the Governor, the Attorney General, the Controller General, the Office of Management and Budget, the Secretary of Finance, the Office of Auditor of Accounts and the Environmental Protection Agency, and is not intended to be used and should not be used by anyone other than these specified parties. However, under 29 Del. C., Section 10002(d), this report is a public record and its distribution is not limited.

*McBride, Shapiro & Co*

Wilmington, Delaware  
October 19, 2006

STATE OF DELAWARE  
DELAWARE WATER POLLUTION CONTROL  
REVOLVING LOAN FUND  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FISCAL YEAR ENDED JUNE 30, 2006

**CURRENT YEAR CONDITIONS**

**CONDITION 06 -01:**

- Condition: Ending cash balances per the Peachtree general ledger for several accounts were significantly out of balance, one more than \$5 million.
- Criteria: Proper internal control procedures require that cash be reconciled on a periodic basis, and any differences adjusted or explained.
- Cause: Discrepancies existed due to misposting between various funds. For example, there were several items that had been posted into the Federal Admin Fund that should have been posted into the Capital Fund. In one situation, the misposting was reversed in the Federal Admin Fund but never entered into the Capital Fund.
- Effect: The various cash balances did not reconcile to the DFMS balances. Consequently, EPA drawdowns and the State Match were significantly understated. Additional time was required by all parties in order to reconcile between timing differences and mispostings, and to determine the proper fund reporting for various transactions. In total, 19 adjusting journal entries were needed for the current year adjustments, which increased the change in net assets by over \$7.2 million.

**RECOMMENDATION:**

The Division of Water Resources' Financial Assistance Branch (FAB) and Accounting Section (AS) cooperate and coordinate to ensure that the following procedures are performed every month:

1. Ensure that the ending balances from the prior month agrees with the beginning balances of the current month.
2. Cumulative differences between DFMS and Peachtree should be reviewed for reasonableness. This will help find any bookkeeping errors, as well as ensure that timing differences that should reverse after one month do so.
3. Unexplained differences should be investigated and corrected on a timely basis if possible.

We believe that regular meetings between the Financial Assistance Branch and Accounting Section are the best way to ensure that the Fund's DFMS and Peachtree accounting is kept in line and that problems are avoided in the future.

STATE OF DELAWARE  
DELAWARE WATER POLLUTION CONTROL  
REVOLVING LOAN FUND  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FISCAL YEAR ENDED JUNE 30, 2006

**AUDITEE'S PLAN FOR CORRECTIVE ACTION:**

The Auditee agrees with the Auditor's Recommendation and will take the recommended steps to ensure the recommended procedures are performed every month and that all necessary checks and balances between FAB and AS will be put into place to avoid reoccurrences of the conditions mentioned above.

**SCHEDULE OF PRIOR YEAR CONDITIONS**

None.